U.S. Recession Scorecard March 2023

History would argue a U.S. recession will arrive later this year

Three of our seven leading indicators of U.S. recession continue to signal an economic downturn is on the way. Two others are still firmly in expansionary territory but are moving (slowly) in the wrong direction. The two employment-related indicators—weekly unemployment claims and the unemployment rate—are at or near their cycle lows and not yet threatening to generate a negative signal.

The indicators that have flipped to recessionary status so far point toward a recession getting underway by late Q2 or early Q3 2023, in our view.

Yield curve (10-year to 1-year Treasuries)

The position of short-term interest rates relative to long-term rates—a.k.a. the shape of the yield curve—has been the most reliable leading indicator of a U.S. recession. Before the start of every recession for the past 75 years, the 1-year Treasury yield has risen above the 10-year yield, indicative of the arrival of tighter credit conditions. About a year

U.S. recession scorecard

Indicator	Status		
	Expansionary	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Economic Index			✓
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories			✓
Fed funds rate vs. nominal GDP growth	✓		

Source - RBC Wealth Management

For important and required non-U.S. analyst disclosures, see page 5.
All values in U.S. dollars and priced as of market close, February 28, 2023 unless otherwise stated.
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after this crossing occurs, on average, a recession begins.

The 1-year yield rose above the 10-year yield decisively last July. The negative gap has widened further over the intervening seven months. **The history of this indicator suggests the U.S. economy will be in recession by summer 2023.**

A majority of U.S. banks continue to raise lending standards (see the January 2023 Fed Senior Loan Officer Opinion Survey released on February 6), extending a trend begun about a year ago. This has added further weight to the inverted yield curve's signal that credit conditions have become more restrictive. Loan payment delinquencies and default rates have been mostly rising but remain low by historical standards. Therefore, credit could remain accessible, albeit more expensive, for some time yet.

ISM New Orders minus Inventories

The difference between the New Orders and the Inventories sub-indexes of the ISM Purchasing Managers' Index has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives—signaling a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than hard data. Therefore, we view this as a corroborative indicator—one to pay attention to if other longer-term indicators are implying a recession is on the way. It has been negative since May 2022 from which point it has steadily worsened. **This measure has never reached this depth before without a recession eventually following.**

Conference Board Leading Economic Index

Historically, this series has given reliable early warnings of recession. When the index has fallen below where it was a year earlier, a recession has always followed—usually two to three quarters later.

This indicator turned decisively negative in Q3 2022, shifting it to the red column on our scorecard. It strongly suggests a U.S. recession will be underway by Q2 2023.

Unemployment claims

This series set its monthly low, so far, for this cycle back in March 2022 at 178,000. The cycle low for claims has typically been registered about 12 months before the start of the next recession. So, if no lower reading is posted in the coming months, its history would suggest a recession could get underway by spring of this year.

As it happens, new monthly claims sagged sharply in January (down to 192,000) getting much closer to the cycle low posted last March. They look to have stayed at about the same level through February. If a new low for claims were to be posted in the coming months then this particular "clock" would have to be reset, pushing out the expected start date of the coming recession. However, RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli points out that seasonal adjustment factors for employment data are suspect around this time of the year because of the usually large number of short-term jobs created leading up to Christmas and the shedding of those jobs early in the new year. Christmas hiring last year was unusually subdued, meaning post-holiday layoffs (and claims) were too. February and March data may bring clarity to this topic.

Unemployment rate

The unemployment rate set a new five-decade low of 3.4% in January. The unusually large number of net new jobs in the nonfarm payroll report looks to have been the biggest contributing factor. But the seasonality factors referred to above

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with respect to claims may have had similar distorting effects on the jobs data.

In our view, a move above 4.0% for the unemployment rate would signal a recession is on the way. Once that signal is given, on average, it has been eight to nine months from the lowest monthly reading until a recession gets underway, although there have been several instances where the time gap was only two to three months.

As for the rest …

Neither the **free cash flow of non-financial corporate business** nor the **fed funds rate vs. nominal GDP growth** appear close to crossing the threshold into a recessionary reading, although in both cases the positive gap looks to be narrowing.

Weighing up the current positioning of all seven indicators and projecting their likely paths over the next couple of quarters continues to point to a growing probability the U.S. will enter recession sometime late in the first half or in Q3 of 2023, in our view. However, absent some notable weakness in the employment data in the coming months, the start date could easily move out later into the second half.

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